

Message Text

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TO SECSTATE WASHDC 5370
INFO AMCONSUL CALCUTTA
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C O N F I D E N T I A L SECTION 1 OF 3 DACCA 3837

PASS AID/ASIA/BIS
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E.O. 11652: GDS
TAGS: EFIN, BG
SUBJECT: BANGLADESH BUDGET 1977-78: ANALYSIS AND COMMENT

REFS: A. DACCA 3457, B. DACCA 3458, C. DACCA 3459

1. SUMMARY. 1977/78 BDG BUDGET (SUMMARIZED REFTELS)
STRONGLY EMPHASIZES PRICE AND MONETARY STABILITY THROUGH
BALANCED BUDGET APPROACH, TIGHT CREDIT AND ONLY SMALL,
IMPLIED INCREASE IN FOOD RATION PRICES. BUDGET ASSUMES
LARGER (1.6 MILLION MT) IMPORTS OF FOODGRAINS AND 500,000
MT PROCUREMENT WHICH WOULD BRING STOCKS UP TO ABOUT 900,000
MT IN JUNE 1978. RESOURCE MOBILIZATION STEPS INCLUDE NEW TAX
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MEASURES WHICH SHOULD IMPROVE REVENUE COLLECTION, AND MODEST
NEW STIMULUS TO PRIVATE INVESTMENT. HOWEVER, BUDGET DOES
NOT PROVIDE FOR REDUCING SUBSIDIES (EXCEPT SMALL IMPLIED
RICE PRICE HIKE) OR LOSSES OF PUBLIC COOPREATIONS. IN-
CREASE OF 16 PERCENT IN PROJECTED DEVELOPMENT SPENDING
IS LESS THAN 19 PERCENT ACTUAL INCREASE IN 1976/77. BUDGETED
AID IS UP 33 PERCENT FROM 1976/77 AND EXCEEDS TOTAL DEVELOP-

MENT BUDGET, REFLECTING INCREASED RELIANCE ON AID. REAL PERCENTAGE OF FUNDS ALLOCATED TO VILLAGE LEVEL AGRICULTURAL DEVELOPMENT DECLINES, WHILE SPENDING FOR DEFENSE MAY GROW SLIGHTLY. ON BALANCE, URBANITES APPEAR TO GAIN MORE FROM NEW BUDGET THAN RURAL CLASSES, REFLECTING PRESIDENT ZIA'S CAUTIOUS APPROACH TO DEVELOPMENT NEEDS AND INCOME REDISTRIBUTION AND HIS CONCERN FOR CONTINUED STABILITY. END SUMMARY.

2. PRICE STABILITY:

A. GENERAL. THIS IS CLEARLY A MAJOR CONSIDERATION. THE NEED FOR SUCH STABILITY IS EMPHASIZED IN THE BUDGET SPEECH (REFTEL A). ABOVE ALL THE GOVERNMENT, FOR POLITICAL AS WELL AS ECONOMIC REASONS, WISHES TO LIMIT RISES IN RICE PRICES (SEE BELOW). THE BUDGET IS BALANCED WITH NO DEFICIT FINANCING, AS IT WAS IN 1976/77. THE BDG WILL HOLD, FOR THE THIRD SUCCESSIVE YEAR, TO ITS STABILIZATION PROGRAM AND TO CREDIT EXPANSION CEILINGS, WORKED OUT WITH THE IMF AS PART OF THE TRUST FUND AGREEMENT.

B. FOODGRAIN PRICES. WE HAVE DESCRIBED THE POLITICAL BACKGROUND TO FOOD PRICE INCREASES IN DACCA 3284. THERE IS NO PROVISION IN THE BUDGET FOR ANY LARGE INCREASE IN RATION PRICES (AS WAS THE CASE IN THE 1975/76 BUDGET). THE NUMBERS DO, HOWEVER, SUGGEST A

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SMALL INCREASE, MORE OR LESS IN LINE WITH THE ENHANCED AMAN PROCUREMENT PRICE (DACCA 3082). THE ACTUAL BUDGETED NUMBERS FOR SALES PROCEEDS FROM RICE ARE:

	QUANTITY	PROCEEDS	PRICE
	(TONS)	(TAKA MILLION)	PER TON
1976/77 (RE)	739,000	1730.0	2341
1977/78 (BE)	700,000	1735.3	2478

ASSUMING UNIFORM SALES OVER THE YEAR, AND A RATION PRICE RISE EFFECTIVE JANUARY FIRST, THE COST OF A MAUND (82 LBS.) OF RICE WOULD RISE ABOUT 10 PERCENT FROM 90 TAKA TO PERHAPS 100. THIS BUDGETARY PROVISION IS IN LINE WITH ASSURANCES WE HAVE THAT THE BDG INTENDS TO RAISE RATION PRICES DURING FY 78, BUT THE AMOUNT OF THE RISE IS NOT VERY LARGE. THE NUMBERS FOR WHEAT CARRY NO IMPLICATION OF PRICE INCREASES.

3. FOOD BUDGET. IN LINE WITH BDG LEADERS' CONCERN OVER FOODGRAIN PRICES AND OVER PAST AND POSSIBLE FUTURE CROP LOSSES, THE BUDGET ASSUMES LARGE INPUT FLOWS IN 1977/78: 300,000 MT OF RICE, AND 1,300,000 MT OF

WHEAT. THE BUDGET SHOWS TOTAL SALES (THIS EXCLUDES RELIEF AN FOOD FOR WORK) OF 700,000 MT EACH OF WHEAT AND RICE, AND PROVIDES FINANCING TO PROCURE DOMESTICALLY 400,000 MT OF RICE AND 100,000 MT OF WHEAT. ALLOWING FOR DISTRIBUTION OF 250,000 MT FOR FOOD FOR WORK, THE BUDGET FRAMERS ASSUMED FOODGRAIN STOCKS WOULD GROW BY 450,000 MT IN 1977/78. THIS WOULD BRING STOCKS ON JUNE 30, 1978 UP TO ABOUT 900,000 MT, SOMEWHAT LESS THAN THE BDG'S GOAL OF ONE MILLION TONS, BUT MUCH GREATER THAN JUNE 1977 STOCKS OF APPROXIMATELY 460,000 MT.

4. DOMESTIC RESOURCE MOBILIZATION:

A. REVENUE COLLECTIONS. DESPITE THE OVER-ESTIMATION
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OF INPORT DUTY COLLECTIONS IN 1976/77 (76 DACCA 4219), TAX RECEIPTS (REVISED ESTIMATES) (RE) EXCEEDED BUDGET ESTIMATES. THE TAX COLLECTION MACHINERY HAS GREATLY IMPROVED IN THE PAST THREE YEARS AND REVENUES ARE BING COLLECTED MORE EFFICIENTLY. THE BDG IS SHOWING STEADY IMPROVEMENT HERE. THE REDUCTION IN INCOME TAX RATES IN 1977/78 WILL DOUBTLESS IMPROVE TAX COMPLIANCE FURTHER.

B. PUBLIC SECTOR INDUSTRIES. THE RECORD HERE IS DISAPPOINTING. THESE INDUSTRIES CONTINUED TO LOSE MONEY, OR EARN VERY LOW RETURNS ON INVESTMENT, IN 1976/77 AND THIS BUDGET CONTAINS NO INDICATION THAT THE BDG HAS TAKEN STEPS TO IMPROVE THIS SITUATION. THE FALL 1976 IBRD RECOMMENDATIONS TO IMPROVE THE JUTE AND TEXTILE INDUSTRIES ARE AT PRESENT UNDER DISCUSSION WITH THE BDG. NONE OF THESE RECOMMENDATIONS ARE ADOPTED IN THIS BUDGET;

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C. SUBSIDY REDUCTIONS. THERE ARE NO SUBSIDY REDUCTIONS IN THIS BUDGET (OTHER THAN THE IMPLIED RICE PRICE INCREASE, PARA 2B ABOVE,) SUCH AS THE INCREASE IN FERTILIZER PRICES ANNOUNCED IN THE 1976/77 BUDGET. THE SUBSIDY PAYMENTS TO THE JUTE MILLS CORPORATION WERE TAKA 200 MILLION IN 1976/77 AND ARE TO BE REDUCED TO 100 MILLION IN 1977/78, BUT WITHOUT EFFECTIVE MEASURES TO REDUCE JUTE MILL LOSSES, PAYMENTS MAY WELL HAVE TO REMAIN AT THE 1976/77 LEVEL. PRESIDENT ZIA, IN HIS JUNE 26 PRESS CONFERENCE ON THE BUDGET, DID STATE QUOTE THE INDUSTRIES AND OTHERS HAD TO STAND ON THEIR OWN AND GOVERNMENT WAS GOING TO GRADUALLY REDUCE SUBSIDIES IN VARIOUS SECTORS FOR THE SAKE OF PROGRESS OF
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THE COUNTRY, UNQUOTE. THUS, SOME SUCH REDUCTIONS MAY COME DURING THE YEAR;

D. OTHER. THE INCOME TAX NET, WIDENED TO INCLUDE AGRICULTURAL INCOME IN 1976/77, HAS NOT BEEN FURTHER EXTENDED THIS YEAR.

5. PRIVATE SECTOR INVESTMENT. THE VARIOUS INCOME TAX MEASURES ARE GENERALLY CONSISTENT; MOST ARE INTENDED TO ENCOURAGE THE PRIVATE SECTOR TO SAVE AND INVEST. THE RATES OF CORPORATION TAX ARE REDUCED, AS ARE PERSONAL INCOME TAXES BELOW THE TOP BRACKETS. GIVEN THE POLITICAL UNCERTAINTIES ASSOCIATED WITH THE COMING ELECTIONS, PLUS THE FACT THAT THE TOP TAX BRACKET REMAINS UNCHANGED, THE STIMULUS TO INVESTMENT MAY WELL PROVIDE TO BE LIMITED. NEVERTHELESS, THIS CONCENTRATED EFFORT TO ENCOURAGE INVESTMENT REFLECTS A GENERAL POLICY GOAL WE STRONGLY SUPPORT.

6. DEVELOPMENT:

A. LITTLE GROWTH IN EXPENDITURES. FOLLOWING A HEALTHY 19 PERCENT GROWTH IN 1976/77 (OVER 1975/76), DEVELOPMENT EXPENDITURES ARE TO RISE NOMINALLY A FURTHER 16 PERCENT IN 1977/78. HOWEVER, GIVEN THE HISTORICAL RECORD OF SHORTFALLS IN DEVELOPMENT EXPENDITURES, THE 1977/78 GOAL IS DISAPPOINTING. THE 1976/77 GOAL WAS FOR A 30 PERCENT RISE;

B. AID DISBURSEMENTS TO RISE. IN 1976/77, FOREIGN GRANTS AND LOANS, AT DOLS 529 MILLION, AMOUNTED TO 80 PERCENT OF DEVELOPMENT EXPENDITURES. FOR 1977/78, SUCH GRANTS AND LOANS ARE BUDGETED TO RISE 33 PERCENT TO DOLS 783 MILLION, RATHER ABOVE THE 742 MILLION BUDGETED FOR DEVELOPMENT. PROJECTED DEPENDENCE ON FOREIGN AID THUS INCREASES IN 1977/78;

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C. SOURCES OF AID. THE FINANCE MINISTRY INFORMS US THAT ESTIMATES AID DISBURSEMENTS WERE (IN DOLLARS MILLIONS):

TYPE OF AID	1975/76(RE)	1976/77(RE)	1977/78(BE)
FOODGRAINS	249	97	259
NON-PROJECT	318	270	304
PROJECT	129	162	220
	696	529	783

FOOD AID REEMERGES AS A MAJOR AID INPUT; INDEED THE BUDGETARY OUTCOME WILL BE HIGHLY SENSITIVE TO FOOD AID FLOWS, SALES LEVELS, AND PROCUREMENT EXPENDITURES. NON-PROJECT ASSISTANCE (INCLUDING EDIBLE OIL IN FOOD BUDGET) HOLDS STEADY, WHILE PROJECT AID DISBURSEMENTS ARE TO GROW 35 PERCENT IN 1977/78, COMPARED TO THE ESTIMATED 25 PERCENT INCREASE IN 1976/77. WE DOUBT PROJECT DISBURSEMENTS IN FACT REACHED 162 MILLION THIS PAST YEAR AND DO NOT BELIEVE THEY WILL AMOUNT TO THE TARGETED LEVEL IN 1977/78 (DACCA 3096);

D. SECTORAL ALLOCATIONS. AGRICULTURE, BROADLY DEFINED AS INCLUDING RURAL DEVELOPMENT AND FLOOD CONTROL AND WATER RESOURCES, RECEIVES APPROPRIATELY THE LARGEST SINGLE SHARE OF THE DEVELOPMENT BUDGET. BUT THAT SHARE IS DECLINING. THE PERCENTAGE FOR RECENT YEARS, AND THE LEADING SECTORS IN 1977/78 ARE.

SECTOR	1974/75	1975/76	1976/77	1977/78
AGRICULTURE	34	32	30	29
INDUSTRY	12	32	30	13
TRANSPORT			16	
POWER			11	

MOREOVER, WHEN ONE ASSIGNS THE DOLS 10 MILLION FOR THE
ASHUGANJ FERTILIZER PROJECT (BUDGETED IN INDUSTRIES)
TO AGRICULTURE, AND SUBTRACTS THE DOLS 48.4 MILLION
FERTILIZER SUBSIDY FROM THE AGRICULTURE DEVELOPMENT
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BUDGET, THE PERCENTAGE IN 1977/78 DECLINES TO 25 PERCENT
GIVEN THE OVERWHELMING IMPORTANCE OF AGRICULTURE AND
RURAL DEVELOPMENT TO THE ECONOMY AND TO DEVELOPMENT,
AGRICULTURE'S SHARE OF DEVELOPMENT OUTLAYS APPEARS TOO
LOW EXPENDITURES ON PUBLIC SECTOR INDUSTRIES BRING
LOW RETURNS, IF NOT LOSSES, AND THE DECLINE IN ITS
SHARE IS WELCOME.

7. WHO BENEFITS? THE URBAN MIDDLE CLASS GAINS; THE MILITARY BENEFITS; THE RURAL MANY DO NOT GET MUCH;

A. DEVELOPMENT EXPENDITURES FAVOR THE URBAN WELL-TO-DO. FOR EXAMPLE, PRIMARY SCHOOL EDUCATION GETS CONFIDENTIAL

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DOLS 3 MILLION IN 1977/78, WHILE UNIVERSITY AND POST-GRADUATE INSTITUTIONS RECEIVE SIX MILLION. CIVIL AVIATION IS TO RECEIVE ALMOST 16 MILLION, MORE THAN RURAL ROADS (DOLS 13.1 MILLION BY A NECESSARILY ARBITRARY CLASSIFICATION);

B. TAX MEASURES, PARTICULARLY THE REDUCTIONS IN INCOME TAX, WEALTH TAX, ESTATE DUTY, AND NUMEROUS INCREASES IN EXEMPTIONS, BENEFIT THE URBAN MIDDLE CLASS. ONLY 200,000 PERSONAL INCOME TAX RETURNS ARE FILED ANNUALLY IN BANGLADESH. SUCH TAX CHANGES CAN ONLY AFFECT THE WELL-TO-DO. WORSE, ONE TAX HITS DIRECTLY AT RURAL EMPLOYMENT. THE MAJOR NEW EXCISE TAX IS A BIRIS, HAND-ROLLED CIGARETTES, PRODUCED BY THOUSANDS OF THE RURAL POOR. THESE WERE HITHERTO UNTAXED. (THIS EXCISE IS TO RAISE DOLS 4.8 MILLION OF THE NET TOTAL OF 10.5 MILLION FROM NEW TAXES.) THIS COTTAGE INDUSTRY HAS EXPANDED RAPIDLY IN RECENT YEARS (TO SALES OF 1.5 BILLION MONTHLY) TAKING SALES AWAY FROM THE LOWER COST BRANDS OF REGULAR CIGARETTES (300 MILLION MONTHLY -- SALES OF MORE EXPENSIVE CIGARETTES RUN TO 700 MILLION). LONG-STANDING EXCISE DUTIES ON REGULAR CIGARETTES ARE AN IMPORTANT REVENUE SOURCE. THIS NEW EXCISE TAX ON BIRIS WILL THUS PROTECT THE ESTABLISHED PRODUCER AND THE GOVERNMENT'S TAX REVENUES, BUT AT THE COST OF INHIBITING THE DEVELOPMENT OF A GROWING RURAL INDUSTRY, OFTEN INVOLVING WOMEN, WHERE UNEMPLOYMENT AND UNDEREMPLOYMENT ARE GREATEST.

8. DEFENSE SPENDING. CONTRARY TO DACCA 3188, REVISED ESTIMATES FOR DEFENSE SPENDING, BROADLY DEFINED (I.E., DEFENSE SERVICES, BANGLADESH RIFLES, VILLAGE DEFENSE FORCES, AND POLICE), IN 1976/77 WERE 17 PERCENT OVER THE BUDGET ESTIMATES. THE \$165.8 MILLION SPENT WAS 13.5 CONFIDENTIAL

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PERCENT OF TOTAL BUDGET EXPENDITURES (REVENUE BUDGET, NON-DEVELOPMENT CAPITAL BUDGET AND DEVELOPMENT). HOWEVER, THIS IS STILL ONLY 1.7 PERCENT OF THE WORLD BANK'S ESTIMATE OF 1975/76 GNP AT MARKET PRICES. TOATL SPENDING

SPECIFICALLY ASSIGNED TO DEFENSE
IS TO INCLINE IN 1977/78 TO \$152 MILLION, OR 9.4 PERCENT OF
TOTAL 1977/78 BUDGET EXPENDITURES. (SOME 200 JAPANESE
TOYOTA JEEPS; SOME SWEDISH VOLVO MILITARY EQUIPMENT, AND
YUGOSLAV AIR FORCE EQUIPMENT, WERE BOUGHT IN 1976/77
WITH FOREIGN EXCHANGE.) BUT CONSIDERABLE MILITARY SPENDING
APPEARS ELSEWHERE IN THE BUDGET AND TOTAL AMOUNT MAY EQUAL OR
EXCEED 1976/77. FOR EXAMPLE, THE HEALTH MINISTRY'S 1977/78
DEVELOPMENT BUDGET INCLUDES \$3.1 MILLION FOR HOSPITALS AND
CLINICS. OF THAT AMOUNT \$1.3, OR ABOUT TWO-FIFTHS, IS FOR
MILITARY HOSPITALS. WE INTEND A FURTHER ANALYSIS OF
DEFENSE SPENDING, BUT IT APPEARS THAT PRESIDENT ZIA HAS PLACED
CONSIDERABLE EMPHASIS ON MILITARY MORALE AND IMPROVED READINESS.
THIS IS NOT SURPRISING CONSIDERING THE IMPORTANCE OF THE
MILITARY TO PRESIDENT ZIA WHO HAS LACKED ANY OTHER
POLITICAL BASE, THE CONCERNS HERE WITH LAW AND ORDER,
INCLUDING EXPENSES OF COPING WITH RAIDERS FROM INDIA,
AND THE LONG NEGLECT OF THE REGULAR ARMED FORCES UNDER
PRESIDENT MUJIB.

9. CONCLUSION. ON BALANCE, THE BUDGET REFLECTS A
CAUTIOUS APPROACH TO BANGLADESH DEVELOPMENT NEEDS.
DEVELOPMENT EXPENDITURES GROW SLOWLY AND DEPENDENCE ON
AID INCREASES; THERE IS NO EFFORT TO TACKLE THE MASSIVE PROBLEMS
OF RESOURCE MOBILIZATION OR CUT LOSSES FROM THE NATIONALIZED
INDUSTRIES, AND NO RECOGNITION OF THE PROBLEMS OF DISTRIBUTIVE
JUSTICE. ON THE OTHER HAND, A RATION PRICE RISE, ALBEIT MODEST,
IS IMPLIED WHICH WOULD IMPROVE FARM, AND HENCE, RURAL
INCOME, AND FUNDS ALLOCATED FOR DOMESTIC PROCUREMENT
OF 500,000 MT OF GRAIN. REVENUE EXPENDITURES ARE TO
INCREASE ONLY 10 PERCENT IN 1977/78 (BE) OVER 1976/77 (RE),
WHILE REVENUE RECEIPTS ARE BUDGETED TO GROW 17 PERCENT THERE-
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BY INCREASING THE REVENUE SURPLUS. THE PRESIDENT'S
STATEMENTS ALSO IMPLY THAT THE PRESENT POLICY DIREC-
TIONS TO SUPPORT AGRICULTURE AND PROMOTE PRIVATE INVEST-
MENT WILL BE STRENGTHENED IN THE FUTURE. AGAINST A
BACKGROUND OF CONCERN OVER RICE PRICE RISES, INCLUD-
ING THEIR POTENTIAL ADVERSE POLITICAL EFFECT, PAR-
TICULARLY AS THE ELECTION PROGRAM IS TO CONTINUE THIS
YEAR, THE STRICT ADHERENCE TO THE IMF STABILIZATION
PROGRAM AND THE DRIVE TO ENSURE LARGE FOODGRAIN IMPORTS
ARE UNDESTANDABLE. WE BELIEVE THE BDG CAN ILL AFFORD
TO MOVE SO SLOWLY IN RELATIVELY GOOD YEARS, BUT WE ARE
NOT SURPRISED THAT LEADERS HERE ARE CAUTIOUS.
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